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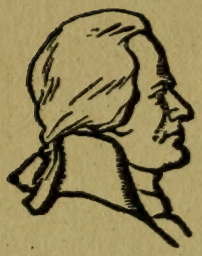
[Modern business Talks]

CREDIT, THE MOTIVE POWER OF BUSINESS

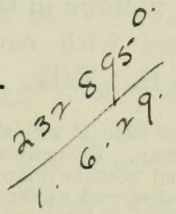


MODERN BUSINESS
TALK No. 15

ALEXANDER HAMILTON INSTITUTE
NEW YORK

Credit, The Motive Power of Business

Number Fifteen of a Series of Modern Business Talks Prepared by the Alexander Hamilton Institute



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NEW YORK

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READING ASSIGNMENT
NUMBER FIFTEEN

"The merchant who 'doesn't owe a dollar in the world' is not ordinarily making the best use of his opportunities, and is not, therefore, conducting his business upon approved lines of good merchandising."—Page 18, Chapter II, Volume 8 of the MODERN BUSINESS Text.

(1) Read this Talk on "Credit, the Motive Power of Business." The giant commercial enterprises of today are built on the foundation of credit. The financial panics which occasionally occur, likewise are caused by credit—that is, by a wrong use of credit. Hence credit may be both constructive and destructive. The present assignment describes the nature and work of that powerful agent.

(2) Read Chapters I to X, (pages 1 to 174 inclusive), of "Credit and the Credit Man," which is the eighth volume in the MODERN BUSINESS Text.

(3) Read with care Lecture No. 8 which accompanies this Talk.

The present time is one of unusual opportunity for the ambitious, wide-awake man. Everywhere the call is heard for men who can plan wisely and execute promptly. But wise planning is based upon sound knowledge, and prompt execution is helped by a study of the methods of other men in similar situations. The man who diligently follows the MODERN BUSINESS Course will soon learn both to plan and to execute.

"It is only by labor that thought can be made healthy; and only by thought that labor can be made happy; and the two cannot be separated with impunity."
—RUSKIN.

Credit, The Motive Power of Business

> *"All but a small fraction of the world's business is transacted with credit as the medium of exchange, tho all such transactions are necessarily measured and recorded in terms of money."*—Pages 8 and 9, Chapter I, Volume 8 of the MODERN BUSINESS Text.

"What should we do without credit, gentlemen?"

The speaker was one of three men in the smoking room of a Pullman, going west on the Twentieth Century Limited.

"I fear it would be rather inconvenient for some of us," laughingly responded one of the others, "but on the whole it wouldn't be a bad thing. Nowadays it is altogether too easy to have things 'charged' and we buy things that really we could very well get along without. It would be better, I should say, to pay cash for all we buy."

"I believe there is another side to that question," said the third man. "I'm inclined to agree with the old gentleman who advised his son never to pay cash when he could get credit. His argument was that the man who always pays cash finds it difficult to obtain credit when he needs it, since such a request in his case is likely to be viewed with suspicion; whereas the person who habitually buys on credit and makes his payments promptly on the date

promised, becomes known as a 'good pay' and readily obtains all the credit he wants."

The first speaker smiled for a moment, then resumed:

"It would be difficult today to get along without railroads, and we should suffer greatly if we were deprived of electricity. It would surely be a calamity if all the printing presses of the world suddenly ceased their hum. Yet all this would be as nothing compared with the loss of credit."

Poverty of Money

Since all but a very small portion of the world's business is transacted by means of credit, it is not difficult to understand that the subject of credit has great importance from the standpoint of successful business management. The combined gold of the world is wholly insufficient to settle the daily clearings of business. Should an attempt be made to do so it would instantly break down.

It is to a study of this interesting subject that the author invites us in the present reading assignment. We shall be well paid for following it closely. After discussing in Chapter I the nature and functions of credit, and pointing out in Chapter II its value as a business builder, the author in Chapter III goes on to a consideration of the various divisions of credit—personal credit, mercantile credit, investment credit, and banking credit. The last of these will come before us again in Volume 16 of the MODERN BUSINESS series, while investment credit is treated in Volume

23, "Investment." Mercantile or commercial credit is that division of the subject with which our present assignment especially deals and in which every business man is necessarily interested.

Relation of Character to Credit

In credit granting, the moral risk is always of great importance. It is not enough that a debtor have plenty of assets; for these may be converted on short notice if the debtor is fraudulent or they may be dissipated if he is lax in his personal morals.

Some years ago a western merchant applied to a well-known Chicago house for a considerable line of credit. He claimed to have a capital of $75,000. During his conversation with the credit man, this merchant volunteered the information that a large portion of his capital was lent on collateral security at a usurious interest rate. Upon learning this, the credit man immediately made up his mind that this clever merchant should pay cash in advance for any goods he might buy there. The moral risk in this case was deemed too great.

The merchant was indignant at the refusal of his request for credit and immediately went to another house in the same city. This house, presumably upon the same information, declared itself willing to extend him a line of credit up to $20,000. Not long afterwards, this man, after obtaining all the goods he could from dealers covering a wide territory, suddenly sold out at less than cost and fled the country.

No less an authority than the late J. P. Morgan declared that character was the one thing to be looked for in the extension of credit. He cited instances in which he had given his check for a million dollars to men whose sole assets were their character. It is highly probable, however, that the acknowledged prince of finance used the term "character" in its broadest sense, including therein elements which others would classify under the head of "capacity." For obviously, integrity of purpose and uprightness of life, however admirable these qualities are in themselves, do not afford a guaranty of success in business. Many beautiful characters have suffered commercial defeat and even financial extinction simply because they lacked the required capacity for business. It is probably for this reason that some credit men have come to regard first-class business capacity coupled with "just a little honesty" as the ideal combination. It is probable that these credit men had suffered as the result of attaching too great importance to a reputation for blameless character without at the same time inquiring carefully into the other factors of business success.

Character without capacity, like capacity without character, is an unsafe combination as a credit risk. Ultimately the former cannot and the latter will not—pay.

What is Business Capacity?

In speaking of business capacity, we do well to remember that this term really includes several

qualifications, among them natural fitness for business, suitable business education, and a sufficient amount of practical experience. A person's age and state of health are also elements to be considered in that connection.

In his discussion of business capacity, the author distinguishes between technical ability and financial ability. In the former he includes a thoro knowledge of the business in which the person is engaged; with the latter he identifies the ability to "swing oneself" so as always to have on hand sufficient funds to meet current obligations. That appears to be an important distinction from the standpoint of a credit giver.

For altho a merchant may know the technical part of his business from A to Z, if he lacks the necessary financial ability, he will sooner or later come to grief. The wide-awake credit man is always on his guard when asked to O. K. an order coming from such a source.

How Much Capital and How Acquired

It is not enough, however, that the credit seeker possess business capacity and a good moral character: He also needs a certain amount of capital. Dun and Bradstreet, as well as other commercial agencies, recognize the importance of capital as the basis of credit. The rating books published by these institutions invariably show the supposed capital possessed by the merchants listed therein.

But it is not always enough that we know how

much capital our customer has. We may want to know how his capital was acquired. Particularly do we want this information if the credit seeker is just starting or has recently started in business. It makes a great deal of difference whether the capital is the result of careful saving during a long period of frugal living, or whether it has been acquired suddenly as a gift or thru inheritance. It is not difficult to understand how capital acquired thru toil and self-denial will be taken better care of by its owner than that which has come to him without labor or effort on his part.

It is not unusual for a credit man to adopt what appears to be a very liberal policy toward persons who by dint of industry and frugality have saved up a little money with the object in view of going into business for themselves.

Elements of Success

"You may think I am extending a rather heavy line of credit to this man," said the credit manager of an Ohio wholesale hardware business in answer to a question, as he pointed to an order blank upon his desk. "I grant you that the amount is more than his capital ordinarily would entitle him to, but I feel perfectly safe in O. K.ing his order, as I regard him as an ideal credit risk.

"My information shows," he continued, picking up an envelop containing the credit data collected in this case, "that he is just twenty-seven and married. For the last seven years he has been employed

as clerk by a local firm and bears an excellent reputation for industry and ability. His moral character is above reproach and he has made a host of friends in this town. He has saved up close to $1,000 and is starting a hardware store and paint shop in a suitable locality. He will carry a stock of about $2,000, of which my house will supply the larger part. His wife is the daughter of rather well-to-do people in a near-by town. It is true he has never before managed a business of his own, but he is a cautious chap and willing to take advice. I see nothing but success ahead for him.

Where Capital Failed

"Less than six months ago," he continued, "I refused to open an account with a young man who had started in business about eighteen months before. He is the son of the postmaster in his town and is a nice enough fellow, tho he has never stayed very long at any one thing. At the time of his marriage his wife's father started him in business operating a sash and door factory, and deposited $3,500 to his account in the local bank. The young man obtained credit without much trouble and got a flying start, but he was too fond of having a good time to pay very much attention to his business. He wasn't a practical man himself, and had to depend upon his foreman for advice and for all technical information. He gave credit freely, but found it very hard to collect from his customers. About six months ago his creditors began to press him for money; and it

was shortly after that that he came to us. He had secured a contract to supply material for a new school building and was promised other contracts in the near future. He was also reported to have given up many of his former pleasures and to be spending more of his time at the factory. In spite of this, however, I declined to take his order unless his father-in-law would guarantee payment. The young man took offense at this suggestion and I saw no more of him until last week when he appeared on the street visibly intoxicated and in the company of several of our local 'sports.' I have grave fears that his business career will soon be at an end."

Lack of attention to business is among the blackest of business sins.

When Competitors Cooperate

One of the most remarkable things in modern business is the changed attitude of merchants toward competitors. Some one evidently discovered that altho bidding for the same business, such competitors really had many interests in common. It was found, for example, that the failure of a customer did no one any good, but that on the contrary such an event was likely to injure many besides the chief creditor.

And so merchants began to exchange confidences. Instead of as formerly guarding jealously from the prying eyes of competitors all information relating to the accounts of customers, lest such knowledge in

some manner should be used to their disadvantage, merchants actually began to open their books for the inspection of competitors and to tell what they knew about their own customers.

That put credit work on a somewhat different basis from that which it had formerly occupied. Instead of depending solely upon the information supplied by the large commercial agencies (Dun and Bradstreet) merchants began to inquire among themselves whether John Smith was paying his bills promptly and whether he was buying in normal quantities. And when such inquiries elicited the fact that he was owing more for merchandise than was good for his business, or that he seldom took cash discounts, or that perhaps claims against him were in the hands of lawyers for collection, said merchant was asked for an explanation before his orders were filled.

References that Mislead

Not long ago a Pennsylvania retail merchant sent an order to a New York house for a bill of goods for early delivery. With the order were the names of a bank and a wholesale house as references. When inquired of, the bank spoke—altho guardedly after the manner of banks—about the integrity and ability of the proprietor who had been known to the bank for a number of years. The wholesale house gave a rather glowing account of business relations sustained with the credit seeker during a period of more than eight years. The commercial rating books showed that the Pennsylvania merchant en-

joyed a capital rating in excess of $30,000 and that his credit rating also was satisfactory. As this appeared to establish his right to credit, the merchant was notified that the goods would be shipped in a week's time.

A day or two later the credit man of the New York wholesale house received a 'phone call from the credit man of another house in the same city, inquiring whether the former was selling the Pennsylvania merchant, and volunteering the information that an order for goods in value of about $500 had been received from him. It appeared that this second house had also received the two references used in the case of the first. The credit man had looked up the merchant's rating and, like his colleague, had found everything all right. The only thing that puzzled him was the merchant's reason for buying goods in New York when he could buy at no higher prices in Philadelphia.

Upon being told that an order for about the same amount had been received by the house inquired of, the credit man whose suspicions had been aroused suggested that a joint effort be made to learn whether Philadelphia supply houses in their line were in a position to throw light on the situation. This was agreed upon and instructions to "hold" the order were sent to the shipping clerks.

A Quiet Investigation

A letter was thereupon drawn up and mailed to every wholesaler and jobber in Philadelphia and

vicinity—twenty-three in all. In this letter the inquirer stated that orders totaling the amount involved had been received from the merchant in question; that these were first orders, and that they were being held pending an investigation of the merchant's activities. The letter asked that in case the recipient was selling the merchant, information be given with regard to the amount owing but not due, and amount owing and past due.

In a few days the answers began to come. Eleven houses reported that they had sold this dealer from time to time. Of these, four stated that they had closed their accounts some time ago owing to the dealer's tardiness in meeting his payments. Two had lost the account when they placed their claims in the hands of an attorney for collection, and five were still selling him. Of these five one said: "We credit him up to $600 (in thirty days). He now owes us $300, none of which is past due. He usually pays at maturity."

Two houses announced that he owed well over $200 past due, and was becoming slower all the time; and two others said they were about to insist upon cash with order until the old account was paid up. Seven houses replied that this merchant had applied for credit during the last year, but that they had declined to open an account.

Stopping a Losing Business

With the information before them, the two New York credit men quickly decided that they did not

wish the dealer's business except on a C. O. D. basis. They understood now why he came into the New York market with his business. One of the credit men, however, was curious to learn how the house given as reference was able to speak so favorably of this dealer, and it sent a representative to obtain, if possible, the information. It was found that the dealer had in this instance not only paid his bills when they became due, but had habitually discounted them.

"We have been surprised at the number of inquiries regarding this customer," said the manager, "but inasmuch as his dealings with us were invariably all right, we could not do otherwise than speak well of him. He always impressed me as a man of solidity and worth."

Further investigation brought to light that this dealer was one of two partners who for a number of years had conducted a profitable business and that upon the death of the other partner this man had arranged to continue the business in his own name. He traded on the prestige of the partnership and had no difficulty in obtaining all the credit he desired. The commercial agency ratings remained unchanged, but evidently the management of the business had suffered greatly thru the removal of the other partner, for the business was now dying of "dry rot." The dealer was finding it increasingly difficult to obtain credit and evidently maintained his credit standing with one large house in order that he might

use that house as a reference in his attempts to get credit elsewhere.

The free interchange of information among the supply houses was putting a stop to the career of this incompetent—tho probably well meaning—dealer before his assets were wholly dissipated.

Publicity is a remedy for many ills—
not least for the ills of credit abuses.

The author's description in Chapter VII of an ideal system of credit interchange whereby credit losses due to the failure of dealers might be eliminated is of interest as showing what undoubtedly can be achieved thru well organized cooperation among supply houses in the same and neighboring markets. Already the tendency is strongly toward cooperation in credit matters, and with so much already accomplished who shall say that the object is unattainable? It is after all only a matter of common sense applied to merchandising.

Need of Uniformity

After showing in Chapters VIII and IX by actual examples how credit reports are analyzed, the author in Chapter X, which is the last of the present assignment, presents a concise discussion of the credit customs that prevail in different lines of business. It will be seen from a perusal of this chapter that credit terms and payment habits vary greatly and that in such matters each trade is a law unto itself. It also appears that in most trades the regulations

which are supposed to govern all credit transactions are not always strictly enforced, and that abuse of credit terms is no rare occurrence. The tendency, however, is manifestly toward a stricter observation of terms and a more uniform credit practice in all lines of trade.

With the increasing appreciation of scientific principles in their application to business problems, and with a growing efficiency on the part of business men, it is hoped that business will rapidly rid itself of the abuses which still exist in its system of commercial credit extension.

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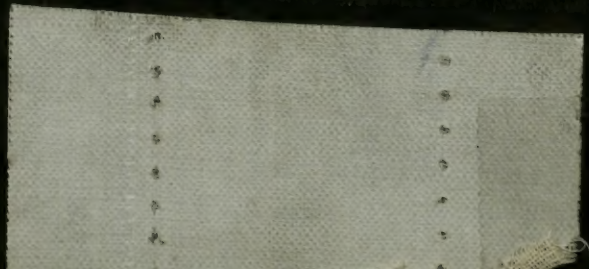

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